

SCHEDULE OF AUDIT FINDINGS AND RESPONSES

1. The City does not have internal controls over financial operations, placing public resources at risk of loss or misappropriation.

Description of Condition

The City of Cosmopolis spends approximately \$3.5 million annually and has 13 employees. The Mayor and City Council appoint the Clerk/Treasurer to process and oversee daily accounting and financial operations. The City's Municipal Code and policies establish some internal controls for the City. Our audit identified the following significant internal control weaknesses:

- Policies are not adequate to establish processes, which ensure public resources, are safeguarded. In addition, the City lacks policies to sufficiently address key financial operations, such as payments with purchasing cards and employee reimbursements.
- The City lacks effective oversight to ensure payments to vendors and employees are valid and supported. Additionally, monitoring is not being performed to ensure policies are adhered to.
- All three finance employees have the ability to modify, delete and add records within the payroll system. There is no independent monitoring to compensate for this risk.
- The City does not have a process in place to ensure records are retained as required per record retention laws.

Cause of Condition

The Mayor and City Council have not placed a high priority on developing processes or ensuring internal controls are in place to safeguard public resources and effectively manage the City's financial operations.

Effect of Condition

The lack of control and oversight of the City's finances increases the risk that misappropriation or misuse of City resources could occur and not be detected in a timely manner. It also places the City at risk of not being able to meet its financial obligations. We communicated concerns with the City's declining financial position in Finding No. 1 of the Financial Statement Audit Report.

Our audit specifically identified the following:

Payroll

We reviewed payroll and leave benefits for three employees and tested to ensure salaries were paid at approved rates and leave was being used and accrued in accordance with policies. Based on the testing performed, we noted the following:

- All electronic payroll records prior to fiscal year 2013 were deleted from the City's system. However, we were able to obtain some system reports to assist in our payroll testing. We also found the City did not retain sufficient documentation to support all employee pay rate changes. As a result, we were not able to support a total of \$644 in payments to two employees.
- City policy states that employees are to be paid monthly, with an optional mid-month draw up to 50 percent of their salary. The employee responsible for processing payroll routinely received more than one draw on their salary. We found that one draw was not deducted from this employee's salary, resulting in an overpayment of \$550. Furthermore, the City has not designated a specific pay date; therefore, employees are paid on different days each month and in some cases prior to their salary being earned.
- Errors in calculating monthly pay rates resulted in a net underpayment of \$666 for one employee.
- Processes were not sufficient to ensure sick and vacation leave was properly accrued and used in accordance with the City's policy. This resulted in City employees using leave prior to earning their leave benefits, accruing excess leave, and not deducting leave taken from balances.

Disbursements

We reviewed a selection of payments to determine whether they were supported and for a valid public purpose. Of the 40 transactions tested, 28 payments (70 percent) were not adequately supported to evidence a valid public purpose. Our audit specifically identified the following:

- The City allows its employees to be reimbursed \$250 each year for non-uniform clothing. We were unable to determine the public purpose of these reimbursements.
- The Mayor serves on the Board of the local Flood Control Authority. Although the financial operations of the Authority are independent from the City, the City reimbursed the Mayor for lost wages, and meals associated with attending these board meetings.

- City officials and staff routinely hold meetings over meals which are paid for by the City. Supporting documentation for these charges, as well as other employee reimbursements, was not sufficient to indicate a clear public purpose.

Recommendation

We recommend the City evaluate its policies and procedures over key financial operations to ensure that internal controls are adequately designed to safeguard public resources. Specifically,

- Perform adequate monitoring procedures to ensure policies are adhered to and payments serve a valid public purpose.
- Limit user access in the payroll system to only those functions each employee needs to perform their job responsibilities and monitor to ensure all changes within the system are allowable and authorized.
- Ensure all payments are for a clear public purpose and adequately supported.
- Ensure records are retained according to record retention requirements.

City's Response

Payroll:

1st bullet

The City now has a new electronic records system in place to secure payroll records. These records are retrievable and are electronically backed up. Procedures will be enacted to provide for documentation supporting employee rate changes.

2nd bullet

The Mayor and Council will review Ordinances, Municipal Codes and Policies and Procedures to ensure compliance by employees. Further, the referenced employee is no longer working for the City. The Mayor will review all exempt employee payroll on a monthly basis.

4th bullet

Appropriate Ordinances, Codes and Policies and Procedures will be revised to ensure appropriate accruals and payments in terms of sick leave and vacation.

Disbursements:

1st bullet

The Mayor will recommend to the Council that "non-uniform clothing" expenditures will no longer be allowed.

2nd bullet

Employees of the City, including the Mayor will no longer be reimbursed wages and meals and related expenses associated with extraneous committees, boards or other civic efforts unless they have been properly delegated or authorized to do so.

3rd bullet

The meetings are typically Council workshops open to the public, held during the dinner hour where Council Members and staff have not had an opportunity to go home and eat prior to the workshop. These workshops are held prior to Council meetings.

Recommendations

1st bullet

The City believes that the foregoing will be adequate to monitor payments to ensure they serve a clear public purpose.

2nd bullet

The Mayor and Council will monitor user access to the Payroll system, limiting access to the City Treasurer and his/her designee.

3rd and 4th bullets

The new electronic records system will alleviate records retention problems and indicate the clear public purpose of payments.

Auditor's Remarks

We appreciate the steps the City is taking to resolve these concerns. We will review the status during our next audit.

Applicable Laws and Regulations

RCW 43.09.200 - Local government accounting - Uniform system of accounting states in part:

The state auditor shall formulate prescribe and install a system of accounting and reporting for all local governments which shall be uniform for every public institution and every public office and every public account of the same class. The system shall exhibit true accounts and detailed statements of funds collected received and expended for account of the public for any purpose whatever and by all public officers employees or other persons.

The accounts shall show the receipt use and disposition of all public property and the income if any derived there from all sources of public income and the amounts due and received from each source all receipts vouchers and other documents kept or required to be kept necessary to isolate and prove that validity of every transaction all statements and reports made or required to be

made for the internal administration of the office to which they pertain and all reports published or required to be published for the information of the people regarding any and all details of the financial administration of public affairs.

Volume 1, Part 3, Chapter 1 of the 2014 Budgeting, Accounting and Reporting System (BARS) manual (3.1.3.10 - 3.1.3.30), issued by the State Auditor's Office pursuant to RCW 43.09.230, states in part:

Internal control is defined by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), in standards adopted by the American Institute of Certified Public Accountants and by the Federal Office of Management and Budget as follows:

Internal control is a process – affected by those charged with governance, management and other personnel designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Effectiveness and efficiency of operations
- Compliance with applicable laws and regulations
- Reliability of financial reporting

Management and the governing body are responsible for the government's performance, compliance and financial reporting. Therefore, the adequacy of internal control to provide reasonable assurance of achieving these objectives is also the responsibility of management and the governing body. The governing body has ultimate responsibility for ensuring adequate controls to achieve objectives, even though primary responsibility has been delegated to management. Since management and the governing body are assumed to work in harmony, both parties are collectively referred to as "management" throughout the rest of this section.

RCW 40.14.070 Destruction, disposition, donation of local government records—Preservation for historical interest—Local records committee, duties—Records retention schedules—Sealed records, states in part,

(2)(a) Except as otherwise provided by law, no public records shall be destroyed until approved for destruction by the local records committee. Official public records shall not be destroyed unless

RCW 40.14.010 Definition and classification of public records, states in part:

As used in this chapter, the term "public records" shall include any paper, correspondence, completed form, bound record book, photograph, film, sound recording, map drawing, machine-readable material, compact disc meeting current industry ISO specifications, or other document, regardless of physical form or characteristics, and including such copies thereof, that have been made by or received by any agency of the state of Washington in connection with the transaction of public business, and legislative records as described in RCW 40.14.100.

For the purposes of this chapter, public records shall be classified as follows:

(1) Official public records shall include all original vouchers, receipts, and other documents necessary to isolate and prove the validity of every transaction relating to the receipt, use, and disposition of all public property and public income from all sources whatsoever; all agreements and contracts to which the state of Washington or any agency thereof may be a party; all fidelity, surety, and performance bonds; all claims filed against the state of Washington or any agency thereof; all records or documents required by law to be filed with or kept by any agency of the state of Washington; all legislative records as defined in RCW 40.14.100; and all other documents or records determined by the records committee, created in RCW 40.14.050, to be official public records.

Washington State Constitution, Article 8, Section 7, Credit Not to be Loaned, states:

No county, city, town or other municipal corporation shall hereafter give any money, or property, or loan its money, or credit to or in aid of any individual, association, company or corporation, except for the necessary support of the poor and infirm, or become directly or indirectly the owner of any stock in or bonds of any association, company or corporation.

Attorney General Memorandum May 14, 1987, Eating and Drinking at Public Expense